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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

~~72~~-1585

HOOVER, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Petitioner prays that a Writ of Certiorari issue to review the Order of the United States Court of Appeals for the Sixth Circuit entered on February 27, 1973.

CITATIONS TO ORDERS AND OPINIONS BELOW

The opinion and decision of the United States Tax Court deciding in favor of the Respondent that there are deficiencies in corporate income tax due from Hoover, Inc. in the amount of $201,636.36 for the years 1963 through 1967 is printed in Appendices C and D and were unofficially reported at T. C. Memo 1972-54. The Order of the Court of Appeals reversing in part and affirming

in part the Tax Court is printed in Appendix A and is not officially reported.

JURISDICTION

The Order of the Court of Appeals was entered on February 27, 1973. The Court of Appeals stayed its mandate for sixty days on March 27, 1973 on the grounds that the Petitioner was preparing a Petition for Writ of Certiorari.

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

THE QUESTIONS PRESENTED

1. Where the Tax Court and the Court of Appeals found the Petitioner corporation to be an indemnitor and the corporation sustains a loss as such, is a deduction permitted pursuant to Section 165(a) of the Internal Revenue Code as a matter of law?

2. Did the lower courts misapply the principles of law established by this Court in *Gregory* v. *Helvering, C.I.R.* v. *Court Holding Company, Higgins* v. *Smith* and *Minnesota Tea Company* v. *Helvering,* so that their decisions are in direct conflict with this Court and the Circuit Courts?

3. As a matter of law, is a transfer from the sole stockholder to the corporation a bonafide indebtedness when the legal criteria set forth in the statute and case law establishes a loan?

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

The statutes involved are the Sections of the Internal Revenue Code of 1954 as amended which is codified as

Title 26 of the United States Code. The Sections relied upon by the Petitioner are as follows: [1]

SEC. 165. LOSSES

(a) General Rule.—There shall be allowed as a deduction *any loss* sustained during the taxable year and not compensated for by insurance or otherwise. (emphasis added)

SEC. 163. DEDUCTIONS - INTEREST.

(a) General Rule.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

STATEMENT

The Tax Court found that Hoover, Inc., a Tennessee corporation with its principal place of business in Nashville, Tennessee, since 1960 has been engaged in quarrying and selling limestone and related products for use in highway and other construction.[2] E. H. Hoover, Jr., during the time in question, was President and owned all of the stock of this corporation.[3]

Hot Mix, Inc. has since 1960 engaged in the business of supplying paving materials and services used for road and highway construction.[4] John L. Burns, Inc. (Burns, Inc.) has been primarily a licensed road grading and general highway construction contractor.[5]

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[1] Sections 165 and 163 are printed in their entirety in Appendix E hereto.

[2] Tax Court Memo Opinion, Appendix C, p. A-7.

[3] Memo Opinion, Appendix C, p. A-7.

[4] Memo Opinion, Appendix C, p. A-7.

[5] Memo Opinion, Appendix C, p. A-7.

In 1964, E. H. Hoover, Jr., having owned 35% of the stock of Hot Mix, Inc., acquired its remaining stock. In 1964, Burns, Inc. became a wholly owned subsidiary of Hot Mix, Inc.[6]

The Tax Court found that Hoover, Inc., Hot Mix, Inc. and Burns, Inc. have from time to time participated in highway construction involving on one project the services and products of two or three of these businesses. It further found that the inter-relationship of these corporations has enabled them to offer general contracting services, subcontracting services and the supplying of materials and to bid on and participate in highway contracting more advantageously than any one of them could do alone.[7]

The Tax Court found that Hoover, Inc. acted only as a supplier and not as a contractor or subcontractor on highway projects and that having available Hot Mix, Inc. as a paving contractor with which to jointly negotiate "package" proposals, had an advantage in securing stone and aggregate sales to other contractors in several states on various roadway construction jobs.[8]

The Tax Court found that Petitioner would require that its stone must be used if Hot Mix, Inc. were permitted to participate. It further found that when a job was bid and a contract obtained by the prime or subcontractor member of this team, Petitioner would then bring in its equipment for opening a limestone quarry and crush the product for sale to Burns, Inc. or Hot Mix, Inc. The Tax Court found that as a result of having a quarry established in a particular construction area, the team could bid competitively on subsequent contracts in the area, and Petitioner as supplier, and Hot Mix,

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[6] Memo Opinion, Appendix C, p. A-7.

[7] Memo Opinion, Appendix C, pp. A-10, 11.

[8] Memo Opinion, Appendix C, pp. A-10, 11.

Inc., acting as a paving subcontractor, could sell their products and services even if the team was not successful in bidding as the prime contractor.[9]

The Tax Court found that Burns, Inc. contracted with the State of Georgia on January 5, 1961 to furnish labor and materials to do certain work on Interstate Highway Project I-75-3 in Georgia. After the work was begun on this project, Burns, Inc. had difficulty in meeting its contract commitments and subsequently, suffered financial loss on the project.[10]

The Fidelity & Casualty Company of New York (Fidelity) as surety furnished bid and performance bonds necessary for Petitioner, Hot Mix, Inc., and Burns, Inc. to bid and perform highway construction jobs.[11]

The Tax Court found that on December 12, 1963, Hot Mix, Inc. and Burns, Inc., as principles, and Hoover, Inc., as indemnitor, entered into a "General Contract of Indemnity" under which all agreed to indemnify Fidelity against any loss resulting from liability on any surety bond which Fidelity might sustain as surety on behalf of either of the principles.[12]

The Tax Court found that on April 13, 1966, a "General Contract of Indemnity" was entered into by Burns, Inc., as principle, and Hot Mix, Inc., two other subsidiaries of Hot Mix, Inc., and Hoover, Inc. as indemnitors and the Continental Insurance Company (an affiliated company of Fidelity) providing that the indemnitors would indemnify Continental in the event of any claims

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[9] Memo Opinion, Appendix C, p. A-11.

[10] Memo Opinion, Appendix C, pp. A-11, 12.

[11] Memo Opinion, Appendix C, p. A-12.

[12] Memo Opinion, Appendix C, p. A-13.

or other losses which the company might sustain as surety on behalf of the principle.[13]

The Tax Court found that after Burns, Inc. began having financial difficulty, Fidelity gave its guaranty to the Commerce Union Bank of Nashville (Bank) in order to obtain for Burns, Inc. and Hot Mix, Inc. a $600,000.00 line of credit.[14] In addition, the Bank required Hot Mix, Inc., its other subsidiaries including Burns, Inc. and E. H. Hoover, Jr. to execute a guaranty to the Bank. All the capital stock of Petitioner, Hot Mix, Inc. and its subsidiaries was deposited with the Bank as collateral.[15] One year later E. H. Hoover, Jr., pledged and assigned $800,000.00 of his personal funds as additional security to Fidelity.[16]

Between October, 1963 and July, 1964, Burns, Inc. borrowed $700,000.00 from the Bank under the lines of credit guaranteed by Fidelity. Burns, Inc. owed to the Bank $594,000.00 on December 1, 1966.[17]

On that date, Fidelity demanded of E. H. Hoover, Jr. that he take such action as required so that Fidelity would be released from any and all obligations which it had to the Bank pursuant to its guaranty.[18]

Fidelity liquidated the personal assets of E. H. Hoover, Jr. and returned them to him.[19]

On December 29, 1966, E. H. Hoover, Jr. by his personal check to Hoover, Inc. loaned it $594,000.00 and re-

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[13] Memo Opinion, Appendix C, pp. A-14, 15.

[14] Memo Opinion, Appendix C, p. A-12.

[15] Memo Opinion, Appendix C, p. A-12.

[16] Memo Opinion, Appendix C, p. A-14.

[17] Memo Opinion, Appendix C, p. A-15.

[18] Memo Opinion, Appendix C, pp. A-15, 16.

[19] Memo Opinion, Appendix C, pp. A-16, 17.

ceived an interest-bearing promissory note. The same day, Hoover, Inc., being liable to Fidelity as an indemnitor, advanced the moneys to Burns, Inc. which in turn paid its indebtedness to the Bank, thereby discharging Fidelity as a guarantor of the Bank.[20]

The effect of the transfers of funds on December 29, 1966 was to insure that E. H. Hoover, Jr. did not loan his personal assets to the then insolvent Burns, Inc. He loaned his $594,000.00 to Hoover, Inc., as it was a solvent, going business from which he expected to recover his loan, plus interest.[21]

The Tax Court concluded that Hoover, Inc. was merely a "conduit" and an unnecessary step in the transactions of December 29, 1966 which was without business purpose and denied it the claimed deduction.[22] It held that if E. H. Hoover, Jr. could place the loss on his corporation, he would not have to bear it personally.[23] Further, that E. H. Hoover, Jr. by advancing the funds to Hoover, Inc. was afforded a source of repayment of funds.[24] It also held without discussion that no debt was created between E. H. Hoover, Jr. when he advanced $594,000.00 to Petitioner and disallowed Petitioner's interest deduction under Section 163(a).[25]

The Tax Court found that Petitioner was an indemnitor, but denied the Petitioner a loss as an indemnitor under Section 165(a) stating that there must be a valid business purpose and that there was none in this case.[26]

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[20] Memo Opinion, Appendix C, p. A-19.

[21] Memo Opinion, Appendix C, pp. A-22, 23.

[22] Memo Opinion, Appendix C, p. A-26.

[23] Memo Opinion, Appendix C, p. A-24.

[24] Memo Opinion, Appendix C, pp. A-23, 24.

[25] Memo Opinion, Appendix C, p. A-26.

[26] Memo Opinion, Appendix C, pp. A-13, 14, 26.

The Court of Appeals in a three paragraph Order held that the Tax Court was clearly erroneous in finding that Petitioner was a guarantor of the Bank. On this point, the Court of Appeals was correct because Petitioner was an indemnitor of Fidelity which was a guarantor of the Bank. However, the Court of Appeals improperly applied the law in affirming the decision of the Tax Court as shall be shown.[27]

REASONS FOR GRANTING THE WRIT

The decisions below should be reviewed pursuant to Rule 19(1)(b) because the Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court; and has decided questions of federal law in a way in conflict with the applicable decisions of this Court and other Circuit Courts.

I

WHERE THE TAX COURT AND THE COURT OF APPEALS FOUND THE PETITIONER CORPORATION TO BE AN INDEMNITOR AND THE CORPORATION SUSTAINS A LOSS AS SUCH, IS A DEDUCTION PERMITTED PURSUANT TO SECTION 165(a) OF THE INTERNAL REVENUE CODE AS A MATTER OF LAW?

The Petitioner first became obligated to Fidelity in 1963 as an indemnitor of the liabilities of Burns, Inc. and Hot Mix, Inc. Fidelity, in turn, had guaranteed the indebtedness of Burns, Inc. at the Bank. Petitioner had given the indemnity to Fidelity so that it would continue as surety on highway construction performance bonds written for Burns, Inc. and Hot Mix, Inc. and would issue bonds for future highway projects.

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[27] Order of Court of Appeals, Appendix A, pp. A-1, 2.

Having recognized that the Petitioner was an indemnitor, the Tax Court nevertheless denied Petitioner's claim that it was entitled to deduct as an indemnitor's loss under Section 165(a) the amount it advanced to Burns, Inc. in December, 1966 pursuant to its indemnity obligation. When Petitioner paid $594,000.00 to Burns, Inc. on December 29, which Burns, Inc. in turn paid to the Bank and thereby released Fidelity on its guaranty to the Bank, Petitioner was in turn released from its liability as an indemnitor to Fidelity for the $594,000.00.

The lower courts improperly applied Section 165(a)[28] which specifically applies to corporations and provides:

> "There shall be allowed as a deduction *any loss* sustained during the taxable year and not compensated for by insurance or otherwise." (emphasis added)

Merten's Law of Federal Taxation sets forth the general rule on the deductibility of an indemnitor's loss as follows:[29]

> ". . . a contract of indemnity is an original undertaking and independent of any collateral contract and *creates a primary liability* . . . payment under an indemnity contract gives rise to *a loss deduction* but not a bad debt deduction." (emphasis added)

In support of its position Hoover, Inc. relies on *Santa Anita Consolidated, Inc.* v. *Commissioner*[30] and *Howell* v. *Commissioner*.[31]

In *Santa Anita Consolidated, Inc.* v. *Commissioner*, *supra*, LATC and CBS in 1959 organized a corporation (POP) to construct and operate an amusement park, investing $1.8 million in stock and guaranteeing a line

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[28] The full text of Section 165 is printed in Appendix E.

[29] Merten's Law of Federal Income Taxation Sec. 28.70.

[30] 50 T.C. 536 (1968) acq., 1969-2 CB 25.

[31] 69 F.2d 447 (CCA 8, 1934).

of credit of $8.75 million. In 1959 LATC transferred its POP stock and paid $4.39 million to Pacific, an unrelated corporation, and received *a release* of its liabilities as guarantor. LATC, the taxpayer, had no right to compensation for its loss under the guaranty by insurance, subrogation or otherwise. The Tax Court held that LATC incurred a loss in 1959 deductible under Section 165(a) for $4.39 million on payment for its release of the guaranty obligation, which payment was irretrievably lost in a transaction closed in 1959. The Court held:[32]

> "Since petitioner suffered a noncompensated loss in 1959, not within the provisions of Section 166, it follows that it is entitled to deduct the $4,396,000 payment under Section 165(a) as claimed."

Other cases supporting this proposition are *Spring City F. Co.* v. *Commissioner*[33] and *D. J. Condit.*[34]

It is clear from the authorities that when a corporate taxpayer such as Hoover, Inc. makes an advance which is not properly considered a loan giving rise to a bad debt (which Hoover, Inc., in agreement with the Tax Court, concedes), the taxpayer is entitled to a deduction under Section 165(a) for a loss not otherwise compensated. That is the situation here.

The Tax Court properly here found the advance was a loss. It had been made because of Petitioner's obligation under the indemnity agreements, so it was plainly a loss of an indemnitor within the meaning of Section 165(a) as applied in the cases cited.

The Tax Court erroneously concluded that Petitioner is not entitled to a loss under Section 165(a) since it had "no valid business purpose" for the December 1966 transactions.

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[32] 50 T.C. 536, 561 (1968) acq., 1969-2 CB 25.

[33] 292 U.S. 182 (1934).

[34] 40 T.C. 24 (1963) affd. 333 F.2d 585 (CCA 10, 1964).

The conclusion of the Tax Court affirmed by the Court of Appeals is contrary to the clear language of the Internal Revenue Code because Section 165(a) does not require that there be "a valid business purpose" before a corporation may take a loss under that code section.

Section 165, which is reproduced in full in Appendix E, puts no limitation on the losses that are deductible by corporations. The section clearly draws a distinction between losses allowable to individuals and losses allowable to corporations and the legislative history of Section 165 indicates that such a distinction was intended in the 1939 Code under Sections 23(e) and 23(f).

Absent any lack of clarity in the meaning of the law set forth in Section 165, the lower court was without authority to interject the "business purpose test" as a requisite to the allowance of a deduction under this Section.

The Tax Court cited in support of its conclusion, that Petitioner could not take a loss under Section 165(a), *International Trading Company*[35] and *Richard R. Riss, Sr.*[36] In these cases a divided Tax Court for the first time set up the test that a corporation may not take a 165(a) loss on property unless it is "held for use in its trade or business." The strong dissents argue that a corporation may deduct under Section 156(a) "any loss" sustained and that Congress did not intend that there must be a business purpose. *International Trading Company, supra,* was submitted to the Court of Appeals for the Seventh Circuit in April, 1973, but has not been decided. *International* and *Riss supra,* raised the "business purpose test" for corporations under 165(a) for the first time.

This case presents an important question of federal law as to whether or not the "business purpose test"

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[35] 57 T.C. 455 (Dec. 28, 1971), No. 46; CCH Dec. 31, 132; appealed to Court of Appeals, 7th.

[36] 57 T.C. 469 (Dec. 30, 1971), No. 47; CCH Dec. 31, 200; appeal nolle pros.

must be met before a corporation may take a loss under Section 165, and this question has not been, but should be settled, by this Court.

This Court has granted certiorari to review the lower courts' interpretation of the tax statutes so that there shall be uniform application of the Internal Revenue Laws. *Turnbow* v. *C.I.R.*,[37] *Parsons* v. *Smith*.[38] Likewise this Court has granted the writ of certiorari where the Tax Court and the Court of Appeals have improperly interpreted a section of the Internal Revenue Law. *C.I.R.* v. *LoBue*.[39]

Petitioner insists that the imposition by the lower courts of the "business purpose test" as a prerequisite to allowing a corporation a 165(a) loss is so important to the uniform application of the tax law that it requires review by this Court.

II

DID THE LOWER COURTS MISAPPLY THE PRINCIPLES OF LAW ESTABLISHED BY THIS COURT IN *GREGORY* v. *HELVERING, C.I.R.* v. *COURT HOLDING COMPANY, HIGGINS* v. *SMITH* AND *MINNESOTA TEA COMPANY* v. *HELVERING*, SO THAT THEIR DECISIONS ARE IN DIRECT CONFLICT WITH THIS COURT AND THE CIRCUIT COURTS?

The Tax Court concluded that the only party to derive a benefit from the method in which the obligation of Burns, Inc. was paid on December 29, 1966 was E. H. Hoover, Jr., personally. It held he was afforded a source of repayment of the funds, and that the Petitioner

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[37] 368 U.S. 337 (1961).

[38] 359 U.S. 215 (1959).

[39] 351 U.S. 243 (1956).

Hoover, Inc. could be saddled with the realized loss so that he would not have to bear it personally. As the controlling stockholder, he could require that the corporation take the loss which caused the Petitioner corporation to be a "mere conduit" having no business purpose in being involved. The lower courts rely on *Gregory* v. *Helvering*,[40] *C.I.R.* v. *Court Holding Company*,[41] *Higgins* v. *Smith*[42] and *Minnesota Tea Company* v. *Helvering*.[43]

The Tax Court concludes that the advance of the money from E. H. Hoover, Jr. to Hoover Inc. and then to Burns, Inc. and subsequently to the Bank must be disregarded as a sham and without economic reality, and the loss of some $594,000.00 must fall on the Petitioner's sole stockholder rather than the Petitioner. The Tax Court having found the close inter-relationship of Petitioner, Hot Mix, Inc. and Burns, Inc. for many years, violates the principles of *Gregory, Court Holding, Higgins and Minnesota Tea, supra*, by only looking at the transaction which occurred on December 29, 1966, rather than examining the entire transaction from its genesis years earlier.

Of course, there is a formal distinction as *Gregory, Court Holding, Higgins* and *Minnesota Tea, supra*, deal deal with corporate reorganizations, liquidations and sale transactions. Here, there is no sale, reorganization or liquidation, but the discharge by Hoover, Inc. as an indemnitor of Fidelity, of a liability incurred three years earlier.

But aside from the formal distinctions, the Tax Court erroneously applied the philosophy of these cases. In

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[40] 293 U.S. 465 (1935).

[41] 324 U.S. 331 (1945).

[42] 308 U.S. 473 (1940).

[43] 302 U.S. 609 (1938).

Court Holding, supra, the Supreme Court emphasizes the search for substance rather than form and declares that "mere formalism, which exists solely to alter tax liabilities" can not be used to disguise the true nature of a transaction. Mere conduits are not to be allowed. *Gregory, supra,* admittedly emphasizes the requirement of a business purpose which may be that of either the corporation or of its stockholders as held in *Survaunt* v. *C.I.R.*,[44] and *Parshelsky's Estate* v. *C.I.R.*,[45] dealing with corporate reorganizations. Even so, the critical factor in *Gregory, supra* as discussed in *Nassau Lens Co.* v. *C.I.R.*[46] was not a tax motive or lack of business purpose, but the "incongruity of the tangible, observable results of the transaction."

The Tax Court concludes that because Petitioner was in a position to save taxes by taking a loss in satisfying its indemnity, such motive is fatal. However, *Gregory, supra,* recognizes that tax liability does not automatically follow because of the stockholder's motive of avoiding taxes. In *U.S.* v. *Cumberland Public Service Co.*,[47] this Court said, "a corporation may liquidate or dissolve without subjecting itself to corporate gains tax, *even though a primary motive is to avoid the burden of corporate taxation.*" (emphasis added)

In December 1966 Hoover, Inc. and its controlling stockholder, both committed on various indemnity agreements, were both faced with deciding exactly how the debt of Burns, Inc. should be absorbed. The Tax Court stresses the fact that Fidelity had, at this time, addressed its demand for payment directly to E. H. Hoover, Jr., and that he had authorized the application

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[44] 162 F.2d 753 (CCA 8, 1947).

[45] 303 F.2d 14 (CCA 2d, 1962).

[46] 308 F.2d 39 (CCA 2d, 1962).

[47] 338 U.S. 451 (1950).

of his pledged funds for the payment of the Bank debt. Therefore, concludes the Opinion, when Fidelity released the funds to E. H. Hoover, Jr. for transfer to Hoover, Inc., to provide the funds for its own advance to Burns, Inc., Hoover, Inc. was nothing more than a conduit. It was not a "necessary step."

We submit that it matters not to whom Fidelity formally addressed its demand. It simply wanted payment to the Bank made through Burns, Inc. and not through Fidelity. It makes no sense in determining what tax liabilities might be within the Hoover "family", to say that the manner in which Fidelity addressed a demand could change the results. Rather, the reality of the entire transaction as related to the business purposes of the Hoover corporation, and E. H. Hoover, Jr., should be determinative. And on whom Hoover might actually call to make the advance to Burns, Inc. is far more significant than Fidelity's call.

The Opinion stresses that E. H. Hoover, Jr., by electing to have his coindemnitor Hoover, Inc. advance the funds, thereby acquired for himself a solvent debtor, so that he would not have to bear the ultimate loss personally. We readily agree that this was done. No case holds that a sole stockholder must act to his personal detriment because it might save taxes for his corporation!

The Opinion complains that when E. H. Hoover, Jr. called on his coindemnitor Hoover, Inc. to make the payment and suffer the loss, Hoover, Inc. accomplished a tax savings. This was because Hoover, Inc. had been successful in its part of the team business and therefore had substantial profits, taxes on which could be reduced by suffering this loss. Tax law does not condemn this.

In discussing *Gregory, Court Holding, Higgins, Minnesota Tea Company, supra,* the Second Circuit has pointed out that these cases *do not* hold that tax mini-

mization is an improper objective of corporate management, but that these cases only hold that transactions even though real, may be disregarded if they are but a sham or masquerade. *Gilbert* v. *C.I.R.*[48] So where a transaction otherwise makes sense, the tax motive is immaterial. Here the tax consideration was at most about $200,000.00. *Three times as important* was the question of whether Hoover, Inc. or E. H. Hoover, Jr., personally, would suffer the loss of some $594,000.00. Plainly this was the primary consideration. The incurring of the indemnity by Hoover, Inc., and the decision to pay as payment was made, entirely aside from taxes, all make good sense, and the fact that Hoover, Inc. saved taxes is not unlawful, nor "even mildly unethical". *Marshall* v. *C.I.R.*[49]

In holding that Hoover, Inc. did "not show a sound business purpose in carrying out the transaction in the manner actually employed," the Tax Court failed to do the very thing which *Gregory* itself says must be done: i.e. examine the entire transaction. That Court's own findings of fact recite in detail how the three-corporation-team had developed complementary businesses, how Hoover, Inc., particularly, prospered from that arrangement, and why Hoover, Inc. and E. H. Hoover, Jr. and others were ultimately required to become indemnitors. All of this had developed long before December 1966. Nevertheless, the Tax Court ignores all of this, as a part of the entire transaction. By so doing, it erroneously ignored the mandate of *Gregory*; it looked to an isolated part of, rather than to the overall import of the entire transaction from beginning to end.

The lower courts further misapplied the law when they drew the distinction between the stockholder's busi-

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[48] 248 F.2d 399 (CCA 2, 1957).

[49] 57 F.2d 633, 634 (CCA 6th, 1932).

ness purpose, which they acknowledge, and the corporation, which they deny. Where a closely held corporation is involved, it actually matters not whether the business purpose is that of the corporation or the stockholder. The distinction between them has been repudiated by the Tax Court itself and is "unrealistic and impracticable." *Lewis* v. *C.I.R.*[50] There it was insisted that no statutory reorganization took place because the plan had been motivated by a "shareholder purpose" and not a "corporate purpose" as required by *Gregory*. The Tax Court had rejected the distinction, and the Appellate Court affirmed, declaring:

> "At one time in applying the so called 'business purpose' test of the Gregory case, the Tax Court did distinguish between 'shareholder purpose' and 'corporate purpose' in closely held corporations. (citations omitted) We think that the Tax Court has been correctly advised in unequivocally repudicating that distinction here. (citations omitted) To seek to differentiate between 'corporate purpose' and 'shareholder purpose' is unrealistic and impractical, particularly with respect to closely held corporations. (citations omitted) The separate legal identity of these corporations should not obscure the fact that they are operated by their shareholders in a manner thought best calculated to serve the latter's interests. *What is deemed best for the shareholders is deemed best for the corporation, and vice versa.* We think it not insignificant that, in affirming the Bazley and Adams decisions, *the Supreme Court gave no countenance to the distinction petitioners advocate.* (citations omitted) (emphasis added)

So even adopting the Opinion of the Tax Court, that there were no business purposes of Hoover, Inc. exclusively, as distinguished from those of its sole stockholder, there still were good business purposes, which the Tax

[50] 176 F.2d 646, 649 (CCA 1, 1949).

Court recognized. The lower courts having made these findings of fact have improperly applied the law because their conclusions denying a loss to the Petitioner clearly conflict with the decisions of this Court and the other Circuit Courts.

This Court has granted the writ of certiorari when decisions of the lower courts were in conflict with this Court's decisions. *Parsons* v. *Smith, supra.* Also, this Court has reviewed when the lower court decision conflicts with the decisions in other Circuit Courts, *U.S.* v. *Donruss Co.*,[51] *U.S.* v. *Correll*,[52] *Equitable Life Assurance Society* v. *C.I.R.*[53]

The misapplication of *Gregory, Court Holding, Higgins* and *Minnesota Tea, supra,* by the lower courts is an absolute departure from the principles set forth in these cases by this Court. Likewise, the lower courts' decisions are in conflict with the Circuit Courts who have construed the *Gregory* line of cases. Clearly review is necessary for a uniform application of the Internal Revenue Laws.

III

AS A MATTER OF LAW, IS A TRANSFER FROM THE SOLE STOCKHOLDER TO THE CORPORATION A BONAFIDE INDEBTEDNESS WHEN THE LEGAL CRITERIA SET FORTH IN THE STATUTE AND CASE LAW ESTABLISHES A LOAN?

On December 29, 1966, E. H. Hoover, Jr. loaned to Petitioner $594,000.00. The Tax Court having concluded that the transfer of funds from E. H. Hoover, Jr. to Petitioner, to Burns, Inc., to the Bank was without legiti-

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[51] 393 U.S. 297 (1968).

[52] 389 U.S. 299 (1967).

[53] 321 U.S. 560 (1944).

mate business purpose, denied that a bonafide indebtedness was created. The undisputed facts in the record show that the transfer from E. H. Hoover, Jr. to Petitioner met the legal criteria to establish a loan.

The Tax Court and Court of Appeals ignored the legal criteria necessary to establish a loan as set forth in the tax cases. See, e.g., *Harlan* v. *U.S.*,[54] *Tomlinson* v. *1661 Corporation*,[55] *Smith* v. *C.I.R.*[56] and *Santa Anita Consolidated, Inc.* v. *Commissioner, supra.*

Under the criteria of those cases, factors to consider in examining each unique fact situation in determining whether there is a loan include—an unconditional and unsubordinated obligation to repay—a note with a fixed rate of interest—book entries—interest paid and reported on tax returns—no voting rights—repayment on principal—a borrower with substantial net worth, rather than a new, expending and under-capitalized business—logical business good sense in doing what was done the way it was done—the stated, obvious and only logical intent of the lender. Here all of these factors lead to the same answer, i.e., a bona fide loan. Indeed, a most persuasive confirmation that there was a loan is the Tax Court's own erroneous condemnation of E. H. Hoover, Jr. having a solvent debtor, rather than suffering the loss himself.

In short, the advance was a loan, and the interest expense is deductible as such under Section 163(a) of the Code, that provides:

> "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."

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[54] 409 F.2d 904 (CCA 5, 1969).

[55] 337 F.2d 291 (CCA 5, 1967).

[56] 370 F.2d 178 (CCCA 6, 1966).

Clearly the lower courts decided the indebtedness question in a way in conflict with the decisions of other Courts of Appeals on the same matter and their decision should be reviewed under the authority of *U. S.* v. *Donruss, supra, U.S.* v. *Correll, supra,* and *Equitable Life Assurance Society* v. *C.I.R., supra.*

CONCLUSION

For the reasons herein set forth, it is respectfully prayed that a Writ of Certiorari be granted to review the Order of the United States Court of Appeals for the Sixth Circuit and the Opinion and Decision of the United States Tax Court.

Respectfully submitted,

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